

Spring 1952

Cooperatives and the Antitrust Laws

Follow this and additional works at: <http://www.repository.law.indiana.edu/ilj>



Part of the [Agriculture Law Commons](#)

Recommended Citation

(1952) "Cooperatives and the Antitrust Laws," *Indiana Law Journal*: Vol. 27: Iss. 3, Article 5.
Available at: <http://www.repository.law.indiana.edu/ilj/vol27/iss3/5>

This Note is brought to you for free and open access by the Law School Journals at Digital Repository @ Maurer Law. It has been accepted for inclusion in Indiana Law Journal by an authorized administrator of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.



JEROME HALL LAW LIBRARY

INDIANA UNIVERSITY
Maurer School of Law
Bloomington

Part IV

Cooperatives and the Antitrust Laws

The foremost legal hazard to the organization and operation of agricultural cooperatives has been the common law and statutory prohibitions against monopolies and restraints of trade. Following many adverse decisions during the 1890's and in the early part of the twentieth century, the courts and legislatures have generally accepted the mere formation of agricultural cooperatives as lawful. Consequently, anti-trust proceedings have been sporadic and usually unsuccessful since World War I. Nevertheless, the state and, more importantly, the federal antitrust laws continue as a potential check on the activities of both purchasing and marketing cooperatives. The extent and effectiveness of their application to cooperatives necessarily requires consideration in an appraisal of agricultural cooperation.¹

The position of cooperatives in our economy is intimately connected with the difficulties posed by the long-term existence of surplus farm production. Shrinkage of the foreign market, a tremendous increase in output per unit of land due to mechanization and technological advances, changes in food consumption habits, and a decrease in the rate of growth of the United States' population have combined to make farm surpluses a recurrent problem, especially since the first World War.² Individual farmers, lacking adequate storage facilities and dependent upon a rapid turnover of harvested crops to meet operating expenses, occupy an extremely disadvantageous bargaining position in disposing of overabundant production to much larger, highly concentrated purchasers.³ The consequent depression of farm prices, such as occurred during the 1920's, drastically reduces farmer income. In turn, decreased purchasing

1. Although the present discussion will consider only the limitations placed upon cooperative activities by the antitrust laws, it should be noted that cooperatives are frequently an effective means of fostering the over-all purpose of the antitrust laws, the checking of monopoly power. One of the most important factors in the rapid growth of agriculture cooperatives has been the desire to avoid the depressed prices resulting from markets controlled by one or a limited number of buyers. See BLANKERTZ, *MARKETING COOPERATIVES* 16 (1940); NOURSE, *THE LEGAL STATUS OF AGRICULTURAL COOPERATION* 12 (1927).

2. DEP'T OF AGRIC., *ACHIEVING A BALANCED AGRICULTURE* 6-17 (1934); EZEKIEL AND BEAN, *ECONOMIC BASES FOR THE AGRICULTURAL ADJUSTMENT ACT* 32-39 (Dep't of Agric. 1933); SCHOFF, *A NATIONAL AGRICULTURAL POLICY* c. 3 (1950).

3. EZEKIEL AND BEAN, *op. cit. supra* note 2, at 40; HERMANN AND WELDEN, *DISTRIBUTION OF MILK BY FARMERS' COOPERATIVE ASSOCIATIONS* 1 (F.C.A. CIRC. No. C-124, 1941); Note, 23 *NOTRE DAME LAW.* 110, 114 (1947).

power at the farm level is an important factor in disruptions of the entire economic system.⁴

The importance of agricultural prosperity both to the farmers and to the national economy has contributed to extensive private and governmental efforts to ameliorate the surplus and other farm problems. Among the earliest methods employed by farmers was collective action through marketing cooperatives. Elimination of middlemen, establishment of storage space, and cumulation of the bargaining power of individual members into a united front served to reduce the farmer's economic disadvantage.⁵ Government action was initially limited to encouragement of cooperative associations. However, following the severe dislocations of the Great Depression, Government measures dealing directly with the surplus problem have multiplied.⁶ The relation of cooperatives to the antitrust laws may well be influenced by future developments in the control of surpluses and the respective roles of Government and cooperatives therein.

STATE ANTITRUST LAWS

Marketing associations endeavor to assure control over a portion of the available supply of the commodity handled, sufficient to create effective bargaining power, by requiring that the member's full production be marketed through cooperative channels.⁷ However, at one time, some state courts refused to enforce these full production agreements as contravening common law, statutory, or constitutional proscriptions against restraint of trade and monopolies.⁸

4. EZEKIEL AND BEAN, *op. cit. supra* note 2, at 8; SCHOFF, *op. cit. supra* note 2, c. 5. See, generally, MEANS, INDUSTRIAL PRICES AND THEIR RELATIVE INFLEXIBILITY, SEN. Doc. No. 13, 74th Cong., 1st Sess. (1935).

5. NOURSE, *op. cit. supra* note 1, at 7; Note, 23 NOTRE DAME LAW. 110 (1947). The failure of cooperatives to achieve significant success in improving farm conditions during the crisis years of the 1920's is noted in DEP'T OF AGRIC., ACHIEVING A BALANCED AGRICULTURE 16 (1934); EZEKIEL AND BEAN, *op. cit. supra* note 2, at 40-44.

6. For some descriptions of the farm program of the Federal Government and proposals for future action, see DEP'T OF AGRIC., ACHIEVING A BALANCED AGRICULTURE (1934); EZEKIEL AND BEAN, *op. cit. supra* note 2; BLAISDELL, GOVERNMENT AND AGRICULTURE c. III (1940); MCCUNE, THE FARM BLOC c. 2 (1943); SCHOOF, *op. cit. supra* note 2; SCHULTZ, REDIRECTING FARM POLICY (1943); WALLACE, AMERICA MUST CHOOSE (World Affairs Pamphlet No. 3, 1934); Shields and Shulman, *Federal Price Support for Agricultural Commodities*, 34 IOWA L. REV. 188 (1949).

7. See PART III, pp. 404-405, *supra*.

8. Georgia Fruit Exchange v. Turnipseed, 9 Ala. App. 123, 62 So. 542 (1913); Burns v. Wray Farmers' Grain Co., 65 Colo. 425, 176 Pac. 487 (1918); Atchinson v. Colorado Wheat Growers' Ass'n, 77 Colo. 559, 238 Pac. 1117 (1925); Ford v. Chicago Milk Shippers' Ass'n, 155 Ill. 166, 39 N.E. 651 (1895); Ludewese v. Farmers' Mutual Co-Operative Co., 164 Iowa 197, 145 N.W. 475 (1914); Reeves v. Decorah Farmers' Co-Operative Society, 160 Iowa 194, 140 N.W. 844 (1913). *Contra: Ex parte Baldwin*

Statutory exemptions of cooperatives from the state antitrust laws were thwarted temporarily by the United States Supreme Court in *Connolly v. Union Sewer Pipe Co.*⁹ Exception of agricultural cooperatives was considered an unreasonable classification violating the equal protection clause of the Fourteenth Amendment. However, the states continued to enact exclusionary legislation, and the *Connolly* case was soon distinguished¹⁰ and eventually overruled.¹¹ Presently, all states have cooperative marketing statutes,¹² which usually authorize formation of marketing cooperatives and the execution of entire output contracts with members.¹³ Under such succoring legislation, the intrastate activities of agricultural cooperatives have almost uniformly prevailed against attacks based on state antitrust laws.¹⁴

The trend of the statutes and decisions reflects a strong public policy favorable to agricultural cooperation. Supporting propositions are that cooperatives benefit the entire public by alleviating the depressed status of agriculture while merely affording farmers protection from unfair prices offered by organized purchasers. And, further, monopolization is impossible or has not occurred.¹⁵ Hence, any restraints on competition are reasonable within the common law "rule of reason" or similar statutory exceptions. However, there are occasional intimations

Co. Producers Corp., 203 Ala. 345, 83 So. 69 (1919); *Burley Tobacco Society v. Gillaspay*, 51 Ind. App. 583, 100 N.E. 89 (1912); *Commonwealth v. Hodges*, 137 Ky. 233, 125 S.W. 689 (1910) (statute); *Owen County Burley Tobacco Society v. Brumback*, 128 Ky. 137, 107 S.W. 710 (1908) (statute); *Castorland Milk and Cheese Co. v. Shantz*, 179 N.Y. Supp. 13 (Sup. Ct. 1919); *Phez Co. v. Salem Fruit Union*, 103 Or. 514, 201 Pac. 222 (1921). For discussions of these and other similar cases, see HULBERT, *LEGAL PHASES OF COOPERATIVE ASSOCIATIONS* 199 (F.C.A. BULL. No. 50, 1942); NOURSE, *op. cit. supra* note 1, c. 14; Hanna, *Cooperative Associations and the Public*, 29 MICH. L. REV. 148, 159 (1930); Tobriner, *Cooperative Marketing and the Restraint of Trade*, 27 COL. L. REV. 827 (1927); Note, 27 VA. L. REV. 674 (1941).

9. 184 U.S. 540 (1902).

10. *Liberty Warehouse Co. v. Burley Tobacco Growers Co-Operative Marketing Ass'n* 276 U.S. 71 (1928); *International Harvester Co. v. Missouri*, 234 U.S. 199 (1914).

11. *Tigner v. Texas*, 310 U.S. 141 (1940).

12. Collected in Jensen, *The Bill of Rights of U.S. Cooperative Agriculture*, 20 ROCKY MT. L. REV. 181, 191 n.29 (1948). The prototype of the majority of these statutes is the Bingham Act, first enacted by Kentucky in 1922. KY. REV. STAT. c. 272 (1946).

13. NOURSE, *op. cit. supra* note 1, at 107; Note, 22 NOTRE DAME LAW. 414 (1947).

14. *E.g.*, *Warren v. Alabama Farm Bureau Cotton Ass'n*, 213 Ala. 61, 104 So. 264 (1925); *Rifle Potato Growers Ass'n v. Smith*, 78 Colo. 171, 240 Pac. 937 (1925); *Clear Lake Cooperative Ass'n v. Wier*, 200 Iowa 1293, 206 N.W. 297 (1925); *Dark Tobacco Growers' Cooperative Ass'n v. Robertson*, 84 Ind. App. 51, 150 N.E. 106 (1926); *Tobacco Growers' Co-operative Ass'n v. Jones*, 185 N.C. 265, 117 S.E. 174 (1923); *List v. Burley Tobacco Growers Co-Operative Ass'n*, 114 Ohio St. 361, 151 N.E. 471 (1926); *Northern Wisconsin Cooperative Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N.W. 936 (1924). See NOURSE, *op. cit. supra* note 1, c. 15; Note, 27 VA. L. REV. 674, 676 (1941).

15. See Arndt, *The Law of California Co-Operative Marketing Associations*, 8 CALIF. L. REV. 281, 284 (1920); Hanna, *supra* note 8, at 165; Tobriner, *supra* note 8; Note, 27 VA. L. REV. 674, 676 (1941).

that, even under state permissive legislation, cooperative restraints are lawful only when "reasonable;"¹⁶ that cooperatives may not restrict production or enhance prices beyond their "true value".¹⁷ Yet, cooperative restrictions on production, although a relatively common practice,¹⁸ have escaped judicial condemnation by the state courts within recent years. And, of course, the "true value" of a product, at least in monetary terms, would not seem to be capable of determination.

At the most, reservations as to "reasonableness" signify that the cooperatives may not engage in flagrantly predatory activities. In view of the general ineffectiveness of the state antitrust laws¹⁹ and the present favorable attitude of the judiciary and legislatures, this should not prove to be a very stringent restriction. Illustrative of the present liberal approach is a recent Ohio case, *Superior Dairy, Inc. v. Stark County Milk Producers' Ass'n*.²⁰ The dairy sought a declaratory judgment that the defendant cooperative, comprising over 90% of the milk producers in the area, violated the state antitrust laws in refusing to sell milk to the plaintiff-distributor unless the plaintiff discontinued a discount system which it had established. A further allegation was that the cooperative intended to fix prices charged milk consumers in the area and to prevent competition in the sale of milk. A demurrer to the complaint was sustained on the ground that the Ohio Cooperative Agricultural Marketing Act,²¹ broadly construed in the light of public policy, exempted the defendant's alleged activities from the state antitrust laws.

The *Superior Dairy* case indicates that marketing cooperatives may enforce retail price maintenance by refusals to sell.²² Under state fair trade acts, consumer cooperatives may be required to maintain minimum retail prices.²³ These acts are normally applicable to cooperatives, and

16. E.g., *Denton v. Alabama Cotton Co-Operative Ass'n*, 30 Ala. App. 429, 7 So.2d 504 (1942); *Starke County Milk Producers' Ass'n v. Tabeling*, 129 Ohio 159, 194 N.E. 16 (1933).

17. See *Tobacco Growers' Co-Operative Ass'n v. Jones*, 185 N.C. 265, 280, 117 S.E. 174, 181 (1923); *List v. Burley Tobacco Growers Co-Operative Ass'n*, 114 Ohio St. 361, 151 N.E. 471, 476 (1926); *Washington Cranberry Growers Ass'n v. Moore*, 117 Wash. 430, 438, 201 Pac. 773, 776 (1921). See Keegan, *Power of Agricultural Co-Operative Associations to Limit Production*, 26 MICH. L. REV. 648 (1928).

18. Tobriner, *supra* note 8, at 835.

19. Comment, 43 ILL. L. REV. 205, 220 (1948); Legis., 32 COL. L. REV. 347, 364 (1932).

20. 89 Ohio App. 26, 100 N.E.2d 695 (1950).

21. OHIO GEN. CODE Ann. § 10186-1 *et seq.* (Cum. Supp. 1951).

22. But Cf. *Hy-Grade Dairies v. Falls City Milk Producers Ass'n*, 261 Ky. 25, 86 S.W. 2d 1046 (1935). Compare *United States v. Colgate & Co.*, 250 U.S. 300 (1919), with *F.T.C. v. Beech-Nut Packing Co.*, 257 U.S. 441 (1922). See Comment, 58 YALE L.J. 1121 (1948), for a general commentary on the legality of refusals to sell.

23. Bunn, *Consumers Co-Operatives and Price Fixing Laws*, 40 MICH. L. REV. 165, 171 (1941). See, on the fair trade laws generally, McLaughlin, *Fair Trade Acts*, 86

a special exemption by a Wisconsin statute was declared unconstitutional by the state court.²⁴ However, patronage refunds should not be condemned under the fair trade laws since refunds neither constitute price cutting on any particular item nor threaten the reputation of any product.²⁵

The practices of cooperatives are in certain instances closely regulated by state control measures, particularly in the milk industry.²⁶ When a cooperative is operating under a valid state marketing order, or other regulatory procedures, the state antitrust laws are inapplicable. And if the state order does not conflict with the operation of the Federal Agricultural Marketing Act,²⁷ or is not otherwise invalid, cooperatives acting in conformity with such order would not be subject to the federal antitrust laws, which do not encompass state action.²⁸

FEDERAL ANTITRUST LAWS

The Sherman Antitrust Act²⁹ has been in effect for approximately 60 years, yet its application to agricultural cooperatives remains uncertain. There is considerable doubt that the Act was originally intended to apply to other than corporations and trusts engaging in interstate commerce.³⁰ However, an early construction included labor unions,³¹ and cooperatives apparently would also be brought within the ambit of the Act. Apprehensive that the mere formation of a cooperative would be considered a combination and conspiracy in restraint of

U. OF PA. L. REV. 803 (1938); Shulman, *The Fair Trade Acts and the Law of Restrictive Covenants*, 49 YALE L.J. 607 (1940); Comment, 61 YALE L.J. 381 (1952).

24. Weco Products Co. v. Reed Drug Co., 225 Wis. 474, 274 N.W. 426 (1937).

25. Bunn, *supra* note 23, at 173. In accord are those cases holding that giving, with each sale, trade receipt coupons which can be used later on the purchase price of any item is permissible under the fair trade acts. *Food & Grocery Bureau v. Garfield*, 20 Cal. 2d 228, 125 P.2d 3 (1942); *Weco Products v. Mid-City Cut Rate Drug Stores*, 55 Cal. App.2d 684, 131 P.2d 856 (1943); *Bristol-Myers Co. v. Lit Bros., Inc.*, 336 Pa. 81, 6 A.2d 843 (1939). *Contra*: *Bristol-Myers Co. v. Picker*, 302 N.Y. 61, 96 N.E.2d 177 (1950). *Compare* *Sperry & Hutchison Co. v. McBride*, 307 Mass. 408, 30 N.E.2d 269 (1940), *with* *Ed. Schuster & Co. v. Steffes*, 237 Wis. 41, 295 N.W. 737 (1941).

26. Cadwallader, *Government and Its Relationship to Price Standards in the Milk Industry*, 22 MINN. L. REV. 789, 809 (1938).

27. See note 67 *infra* and accompanying text.

28. *Parker v. Brown*, 317 U.S. 341 (1942). Of course, a state may not insulate cooperative activity from the federal antitrust laws simply by means of permissive legislation. The state itself must provide the machinery of control to come within the *Parker v. Brown* decision. *Id.* at 351.

29. 26 STAT. 209 (1890), as amended, 50 STAT. 693 (1937), 15 U.S.C. §§ 1-7 (1946).

30. Schmidt, *The Application of the Antitrust Laws to Labor: A New Era*, 19 TEX. L. REV. 256 (1941) surveys the controversy over the intended scope of the Sherman Act, with particular reference to labor unions.

31. *Loewe v. Lawlor*, 208 U.S. 274 (1908); Schmidt, *supra* note 30.

trade, as some state courts had already held,³² cooperative associations pressed for legislative exemptions.

These efforts culminated in the Clayton Act,³³ enacted in 1914, and the passage of the Capper-Volstead Act³⁴ in 1922. Section 6 of the Clayton Act provides that the federal antitrust laws are not to forbid the existence or operation of non-stock, non-profit labor, agricultural, or horticultural organizations, and are not to restrain the lawful effectuation of their legitimate objects; nor are such organizations to be considered illegal combinations or conspiracies in restraint of trade.³⁵ The Capper-Volstead Act authorizes the organization of marketing cooperatives on a capital stock basis, and sanctions common marketing agencies and execution of necessary contracts and agreements.³⁶

Uncertainty as to the precise scope of the exemption afforded cooperatives by the Clayton and Capper-Volstead Acts was partially resolved by *United States v. Borden Co.*,³⁷ the only relevant Supreme Court decision. A criminal action was instituted charging a combination and conspiracy among a milk cooperative and its officials, milk distributors, a labor union, and city officials to fix prices and control production in the Chicago fluid milk market. Reversing the conclusion of the lower court that agriculture cooperatives were absolutely exempt from the antitrust laws, the Supreme Court held that such an organization could violate the Sherman Act by combining and conspiring with others.

However, there is still no authoritative answer to the question whether a cooperative association acting alone or in concert with other cooperatives is entirely without the provisions of the Sherman Act. The *Borden* case is not decisive on this proposition. The opinion was expressly limited to the situation where the cooperative conspires with others. In the somewhat analogous area of the application of the Sherman Act to labor unions, a union is not subject to the Act when it proceeds independently,³⁸ even though conspiracy with non-union parties

32. See cases cited in note 8 *supra*.

33. 38 STAT. 730 (1914), as amended, 15 U.S.C. § 12 *et seq.* (1946).

34. 42 STAT. 388 (1922), 7 U.S.C. §§ 291-292 (1946).

35. 38 STAT. 731 (1914), 15 U.S.C. § 17 (1946).

36. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946). The Act requires qualifying associations to conform to traditional cooperative principles. The association must be operated for the mutual benefit of members, and either each member must be given one vote or dividends on stock and membership capital must be limited to 8 per cent yearly. In addition, the cooperatives may not deal with the products of nonmembers to a greater extent than with the products of members.

37. 308 U.S. 188 (1939). For a popular account of the background of this case, see *Milk in Chicago*, *Fortune Magazine* 80 (Nov. 1939).

38. *United States v. Hutcheson*, 312 U.S. 219 (1941).

is actionable.³⁹ Thus, in *United States v. Dairy Cooperative Ass'n*,⁴⁰ a Federal District Court refused "to scuttle the plain language of the Clayton Act, as antilabor courts scuttled the labor provisions of the same act," and held that monopolistic conduct by a cooperative was not illegal when other parties were not involved. Some support for this position can be found in the legislative history of the Clayton and Capper-Volstead Acts,⁴¹ although there are equally persuasive statements to the contrary.⁴²

A more powerful argument for a broad construction of the cooperative exemption is the divergence between government policy towards competition in agriculture as compared with the policy to encourage and protect competition contemplated by the antitrust laws. The maintenance of effective competition, the nexus of antitrust policy,⁴³ is not the principal consideration in the present governmental approach to agricultural problems. Rather, the emphasis increasingly has been to control and channelize competition among producers of agricultural commodities. The government has permitted, or actually enforced, limitations on production and has controlled prices of certain farm products under the Agricultural Marketing Act.⁴⁴ And it has sought to establish floors under the prices received by farmers by means of the parity formula.⁴⁵ From this, it might be persuasively contended that the Clayton and Capper-Volstead provisions were merely the first step of a government program to lessen rather than promote competition among agricultural producers and to procure higher prices for farmers rather than lower prices for consumers; consequently, the antitrust exemptions should be broadly construed to prevent the agricultural program from being crippled by the conflicting purposes of the antitrust laws.

39. *Allen Bradley Co. v. Local Union No. 3*, I.B.E.W., 325 U.S. 797 (1945).

40. 49 F. Supp. 475 (D. Ore. 1943). See *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 229 (N.D. Iowa 1949); *United States v. Elm Spring Farm*, 38 F. Supp. 508, 511 (D. Mass. 1941). See Jensen, *supra* note 12, at 189.

41. E.g., *Speech of Senator Kellogg*, 62 CONG. REC. 2049 (1922); *Speech of Senator Fletcher*, 62 CONG. REC. 2107 (1922). See Kovner, *The Legislative History of Section 6 of the Clayton Act*, 47 COL. L. REV. 749 (1947).

42. E.g., *Speech of Representative Volstead*, 61 CONG. REC. 1033 (1921). See Hanna, *Antitrust Immunities of Cooperative Associations*, 13 LAW & CONTEMP. PROB. 488, 493 (1948).

43. See *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 490-500 (1939).

44. See note 67 *infra* and accompanying text.

45. Agricultural Adjustment Act of 1938, 52 STAT. 31 (1938), as amended, 7 U.S.C. § 1282 *et seq.* (Supp. 1951). This statute also provides for the governmental promulgation of marketing quotas for certain crops, including tobacco, wheat, and cotton. For further information on governmental farm legislation and policies, see BLAISDELL, *op. cit. supra* note 6, especially c. III; DEERING, *USDA MANAGER OF AMERICAN AGRICULTURE* (1945); LARSON, *AGRICULTURAL MARKETING* c. 24 (1951); Shields and Shulman, *supra* note 6.

Nevertheless, an equally convincing argument can be advanced that cooperatives, acting alone, are not totally excluded from the operation of the Sherman Act. Section 6 of the Clayton Act appears to be primarily concerned with removing the threat that the mere existence of a cooperative would be an illegal restraint of competition, and speaks of "lawfully carrying out the legitimate objects thereof." Relying upon this emphasis on legality, the Court soon construed Section 6 to leave labor unions, as organizations, subject to all the prohibitions of the Sherman Act.⁴⁶ Later decisions virtually removing unions from the restrictions of the Act were predicated on an interaction of the Norris-LaGuardia Act⁴⁷ with the Clayton Act Section 6.⁴⁸ Of course, the Norris-LaGuardia Act is not concerned with agricultural cooperatives. The Capper-Volstead Act merely extended the privilege of organizing cooperatives free from the restraints of the antitrust laws to those having capital stock and paying dividends and does not expressly purport to give a complete immunity.

Although governmental farm policy has frequently fostered controlled prices and production of some agricultural products, this control has been under the direction or supervision of government agencies. As such, it affords little justification for allowing *private* groups, responsible to no one except their own members, to exercise such powers with impunity. There would seem to be a considerable public interest in the maintenance of an abundant supply of food, and other vital farm commodities, at reasonable prices. Some public restraint should be maintained over private groups controlling, or having the potentiality to control, this fundamental segment of our economy.

Should a narrow construction of the cooperative exemption be accepted, farmers would be placed nearly on a par with corporations under the antitrust laws. Association of farmers into cooperative groups for joint action would not be *per se* illegal. Thus, farmers could mitigate the handicap of competing among themselves in a situation of almost perfect competition while buying and selling in markets often under monopoly, oligopoly, or lesser degrees of control. Yet, cooperative

46. Duplex Printing Press Co. v. Deering, 254 U.S. 443 (1921). See GREGORY, LABOR AND THE LAW c. 8-9 (Rev. ed. 1949). United States v. King, 229 Fed. 275 (D. Mass. 1915), 250 Fed. 908 (D. Mass. 1916), the only important federal case arising between the enactment of the Clayton and Capper-Volstead Acts, held that a potato cooperative which blacklisted and boycotted certain nonmembers engaged in an illegal restraint of trade under the Sherman Act. The cooperative was not exempted by the Clayton Act Section 6 since these activities were not "lawful."

47. 47 STAT. 70 (1932), 29 U.S.C. § 101 *et seq.* (1946).

48. United States v. Hutcheson, 312 U.S. 219 (1941). See Gregory, *The New Sherman-Clayton-Norris-LaGuardia Act*, 8 U. OF CHI. L. REV. 503 (1941); Schmidt, *supra* note 30, at 287.

groups, as entities, could not combine or conspire with others in restraint of trade in violation of Section 1 of the Sherman Act, nor could they legally acquire monopoly control over the market, alone or in combination with others, in violation of Section 2 of the Act.⁴⁹

Collective action between two or more cooperatives could constitute a "combination or conspiracy with others" within the meaning of the *Borden* case, and thus be non-exempt if in restraint of trade. However, federated cooperatives are so tightly interwoven and centrally controlled that they are in fact, as well as theory, one large cooperative.⁵⁰ Hence, they should come within the exemptions which the law affords individual cooperatives, and not be considered a loose combination of their respective units. The Capper-Volstead Act expressly legalizes common marketing agents for cooperative associations coming under the Act.⁵¹ In addition, the Cooperative Marketing Act authorizes the acquisition, interpretation, and exchange of past, present, and future crop and market statistics among associations and federations of marketing cooperatives.⁵² These provisions seemingly neutralize those cases finding trade associations to be in violation of the Sherman or Federal Trade Commission Acts to the extent that such cases were based on the exchange of detailed pricing and production information and the consequent pressure to conform, inherent in the exchange.⁵³ But, more concrete efforts to assure adherence to uniform prices would not necessarily be legalized.

49. Some excellent articles on the present status of the antitrust laws and the policies influencing their application are: Adelman, *Integration and Anti-trust Policy*, 61 HARV. L. REV. 27 (1949); Chadwell and McLaren, *The Current Status of the Anti-trust Laws*, (1950) U. OF ILL. L. FORUM 491; Fuchs, *Economic Considerations in the Enforcement of the Antitrust Laws of the United States*, 34 MINN. L. REV. 210 (1950); Levi, *The Antitrust Laws and Monopoly*, 14 U. OF CHI. L. REV. 153 (1947); Peppin, *Price-Fixing Agreements under the Sherman Anti-Trust Law*, 28 CALIF. L. REV. 667 (1940); Rostow, *Monopoly under the Sherman Act: Power or Purpose*, 43 ILL. L. REV. 745 (1949); Rostow, *The New Sherman Act: A Positive Instrument of Progress*, 14 U. OF CHI. L. REV. 567 (1947); Wood, *The Supreme Court and a Changing Antitrust Concept*, 97 U. OF PA. L. REV. 309 (1949).

50. See PART I, p. 364, *infra*.

51. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946).

52. 44 STAT. 803 (1926), 7 U.S.C. § 455 (1946).

53. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *The Sugar Institute, Inc. v. United States*, 297 U.S. 553 (1936); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. American Linseed Oil Co.*, 262 U.S. 371 (1923); *American Column & Lumber Co. v. United States*, 257 U.S. 377 (1921). See also, *Appalachian Coals, Inc. v. United States*, 288 U.S. 344 (1933); *Maple Flooring Manufacturers Ass'n v. United States*, 268 U.S. 563 (1925); *Tag Manufacturers Institute v. F.T.C.*, 174 F.2d 452 (1st Cir. 1949). The activities of trade associations in assembling and distributing market statistics were important factors in these cases only when the information enabled the association members to fix prices or to engage in imperfect competition by making it possible for each member to discern what his competitors were doing, and the probable effect of his actions upon competitors and upon the market. The particularity of pricing and production information, whether

Even should the cooperative exemption be strictly construed, the control of the market necessary to constitute illegal monopolization is uncertain. The *Alcoa* case⁵⁴ found that 90% control of aluminum ingot production was monopolistic and there were dicta that two-thirds control would probably be sufficient; at least where there was a general intent to monopolize.⁵⁵ Accepting the rationale of the *Alcoa* opinion, that a monopoly is illegal *per se* because it has the power to control prices, which is illegal *per se*, an organization that acquires and exercises power to substantially affect or fix prices in the market monopolizes in violation of Section 2.⁵⁶ Where there is a specific intent to monopolize, control over a much smaller percentage of the market may comprise an illegal attempt to monopolize.⁵⁷ Furthermore, the illegal monopoly or restraint may be of an identifiable local market.⁵⁸

Monopoly control over a market by a cooperative is improbable, whatever the lower limits of monopolization may prove to be, where a crop or livestock is grown over a large area and marketed nationally. The large number of individual farmers involved, together with the relative ease of entry and egress from the market, would make effective control over a considerable period of time nearly impossible.⁵⁹ However, cooperatives have and do exercise up to 100% control over the production and sale of certain commodities, which are either grown in a limited, contiguous geographic area, such as cranberries and citrus fruit, or have primarily a localized market, as the fluid milk market.⁶⁰

knowledge of past practices or future plans was disseminated, the availability of the statistics to outsiders, and the pressure, both moral and legal, brought on members to refrain from price-cutting are relevant factors having varying weight in the decision of the cases. See, generally, Donovan, *Trade Association Administration and Protection under the Antitrust and Other Laws*, 30 GEO. L.J. 17, 149 (1941); Hale, *Agreements Among Competitors: Incidental and Reasonable Restraints of Trade*, 33 MINN. L. REV. 331 (1949).

54. *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

55. *Id.* at 424. The court also stated that control of one-third of the market would definitely not be monopolistic. This dictum has been criticized as "unrealistic." Fuchs, *supra* note 49, at 217. See Handler, *Industrial Mergers and the Anti-Trust Laws*, 32 COL. L. REV. 179 (1932), for a description of difficulties encountered in the earlier cases in determining the percentage of market control necessary for a Section 2 violation.

56. *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945). See Levi, *supra* note 49, at 175.

57. *United States v. Yellow Cab Co.*, 332 U.S. 218 (1947), 338 U.S. 338 (1949); *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948).

58. *Lorain Journal Co. v. United States*, 72 S.Ct. 181 (1951); *Indiana Farmer's Guide Pub. Co. v. Prairie Farmer Pub. Co.*, 293 U.S. 268 (1934).

59. NOURSE, *op. cit. supra* note 1, at 428; Tobriner, *supra* note 8, at 828; SEN. REP. No. 236, 67th Cong., 1st Sess. 2 (1921).

60. SEN. REP. No. 236, 67th Cong., 1st Sess. 2 (1921). The percentage of cooperative control in any particular product or area is subject to considerable variation from year to year, depending upon membership, productivity of members as compared with nonmembers, and other variables. Moreover, there is often intensive inter-product compe-

If the number of cases is any criterion, the most pressing antitrust problems involving agricultural cooperatives arise from the marketing of fluid milk. The seasonal fluctuations of supply, without commensurate variations in demand, the perishable quality of the product, and the geographically limited market create potentially ruinous competitive situations.⁶¹ Such conditions are highly conducive to cooperation, integration, and other practices designed to limit competition and maintain profitable prices, and have contributed to almost nation-wide adoption of classified price plans for the sale of fluid milk from producers to handlers.

Essentially, the classified price plan achieves an artificial differentiation in milk prices dependent upon use. A substantially higher price is paid for Class I milk, that marketed as fluid milk to ultimate consumers, than for Class II milk, which is processed into manufactured dairy products.⁶² The milk producers receive a "blend" price based upon an average of fluid and manufactured milk sales over a specified period, irrespective of the actual utilization of their particular shipments of milk.

The maintenance of this rigid price differential requires a high degree of cooperation by producers, handlers, and distributors, or alternatively monopoly control at one stage of the marketing process.

tion among farm commodities and competition from foreign sources is frequently a potent factor.

No available single source for complete statistics on the control exercised by cooperatives over the various agricultural commodities is known. The following figures, while approximations, are thought to be somewhat representative. They are illustrative only and are not intended to be inclusive of all instances of considerable market control; nor is it suggested that a monopoly necessarily exists. Unless otherwise indicated, statistics are taken or computed from the Annual Report or other publication of the organization.

California Walnut Growers Ass'n—85% of shipments of in-shell walnuts during 1950. American Cranberry Exchange—53% of 1950 cranberry crop. Maine Potato Growers, Inc.—26.5% of 1948-49 shipments of seed potatoes. California Fruit Growers Exchange—74% of California-Arizona citrus fruit (43.4% of total U.S. production) (reported in GARDNER AND MCKAY, *THE CALIFORNIA FRUIT GROWERS EXCHANGE SYSTEM* 7, 14 [F. C.A. CIRC. No. C-135, 1950]). California Almond Growers Ass'n—70% of 1946-47 crop (reported in 15 *News for Farmer Cooperatives* 12 [Aug. 1948]). FTC, *REPORT ON THE SALE AND DISTRIBUTION OF MILK PRODUCTS* (1935-37) contains the findings by the Federal Trade Commission investigation of several large milk marketing areas. The percentage of milk production controlled by a single cooperative ranged up to the 85% supplied Minneapolis and St. Paul by the Twin City Producers Ass'n. See Cadwallader, *supra* note 26, at 818-821.

Monopoly control by purchasing cooperatives is also possible, especially when they have manufacturing facilities. However, as yet they do a relatively small amount of business when compared with similar non-cooperative enterprises. See Part I, pp. 356-358, *infra*. Purchasing associations do not come within the provision of the Capper-Volstead Act, which suggests that the antitrust laws may be more broadly applicable to such cooperatives.

61. Cadwallader, *supra* note 26; Hanna, *Cooperative Milk Marketing and Restraint of Trade*, 23 Ky. L.J. 217, 235 (1935).

62. Under some plans, there are three classes rather than two. See the articles cited in note 61 *supra* for a more detailed exposition of the operation of these plans. Also, see *Let 'em Drink Grade "A"*, *Fortune Magazine* 83 (Nov. 1939).

The role of cooperatives varies from market to market. They may function only as a bargaining agency for their member producers, or in addition perform milk collection duties. Some cooperatives extend their functions to wholesale or retail distribution or both and provide facilities for manufacture of surplus milk.⁶³ Occasionally, they are the overall policing agency for the market. Since the cooperatives would ordinarily be forced to collaborate with other parties, there is little doubt that their activities fall within the coverage of the antitrust laws, where they have not been governmentally sanctioned. And the maintenance of a classified price plan undoubtedly can be an illegal restraint of trade. Combinations and conspiracies to fix prices are *per se* violations of the Sherman Act.⁶⁴

Despite the apparent vulnerability of the classified price plan, and of the cooperatives supporting it, the system has continued to flourish. Partially accounting for this paradox are the relatively small-scale restraints resulting, the inadequate personnel of the Department of Justice Antitrust Division, interstate-intrastate commerce difficulties, the fact that strong competition often remains with entry into the field relatively easy, and a general recognition that unrestrained competition could be particularly ruinous.⁶⁵ Moreover, a recent proceeding against an association controlling 80% of the milk produced in the Washington, D. C. area ended in dismissal, the Circuit Court indicating that any restraint on trade by the classified price plan accompanied by contracts requiring distributors to obtain their full milk requirements from the association was reasonable under the circumstances.⁶⁶

63. Receiving associations collect the milk from producers, usually in outlying parts of large markets, provide necessary physical equipment for cooling, shipment, etc., and sell to the most favorable sales outlet. Bargaining associations do not actually handle the milk, but merely procure a sales outlet for each member, who ship directly to the purchasers. Distributing cooperatives take possession of the milk and dispose of it in the wholesale and retail markets. Processing cooperatives convert the milk into butter, cheese, ice cream, and other dairy products. Varying combinations of these functions in one cooperative association are frequent. See FETROW AND ELSWORTH, *AGRICULTURAL COOPERATION IN THE UNITED STATES* 45-60 (F.C.A. BULL. No. 54, 1947); HERMANN AND WELDEN, *op. cit. supra* note 3.

64. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927). But see *Maryland & Virginia Milk Producers Ass'n v. United States*, 193 F.2d 907 (D.C. Cir. 1951), commented upon in note 66 *infra*.

65. Investigation of the Milk Industry (Detroit, Michigan, Area), Dep't of Justice Public Statement, Oct. 15, 1938; Investigation of Milk and Dairy Products Industries (New York City), Dep't of Justice Public Statement, June 3, 1940.

66. *Maryland & Virginia Milk Producers Ass'n v. United States*, 193 F.2d 907 (D.C. Cir. 1951). The actual holding of the case, a criminal prosecution, was that the necessary intent to suppress and eliminate competition by means of full supply contracts providing for classification-utilization pricing had not been proven beyond a reasonable doubt. However, the court appeared to be greatly impressed by testimony that the "classified

The major support sustaining private regulation of the local milk sheds, however, is the promulgation of federal marketing agreements and orders under the Agricultural Marketing Act of 1937.⁶⁷ After proper notice and hearing, the Secretary of Agriculture may enter into marketing agreements with processors, producers, associations of producers, and others engaged in the handling of any agricultural commodity in interstate commerce.⁶⁸ Moreover, he may issue marketing orders, either in conjunction with or without a marketing agreement, governing the production and distribution in interstate commerce of certain farm commodities, including milk, tobacco, and certain fruits and vegetables.⁶⁹ Express permission is granted for inclusion in such orders of the classified system of milk pricing with payment of blended prices to producers.⁷⁰ The Secretary may select a common agency to administer the marketing order⁷¹ and he may mediate disputes which arise.⁷²

Marketing agreements formulated under the Act are specifically exempted from the antitrust laws,⁷³ as are arbitration awards.⁷⁴ And, of course, practices prescribed by the government marketing orders are not subject to the antitrust laws.⁷⁵ However, private restrictive practices cannot be assured judicial approval merely because they could be brought under a federal marketing order, or had previously existed under an expired order.⁷⁶ Furthermore, only the prices paid to producers

use pricing system is economically sound, [and] in practice it is responsive to competition and levels off to the same result in money as does the flat price." *Id.* at 916. The court seemingly thought immaterial the fact that an artificial differentiation in the prices charged various users was maintained so long as not shown to have been "wielded to the disadvantage and detriment of the public." *Id.* at 916. This despite the well established doctrine that price fixing is illegal *per se*. See cases cited in note 64 *supra*. For further comment on the requirements contracts aspect of this case, see p. 445 *infra*.

67. 50 STAT. 246 (1937), 7 U.S.C. § 601 *et seq.* (1946).

68. 50 STAT. 246 (1937), as amended, 7 U.S.C. § 608(b) (Supp. 1951). For a description of marketing agreements formulated under a similar statute, see NOURSE, *MARKETING AGREEMENTS UNDER THE AAA* (1935).

69. 50 STAT. 246 (1937), as amended, 7 U.S.C. § 608(c) (Supp. 1951). It is interesting to note that the products which may come under the marketing orders include almost all those in which monopoly control by a cooperative has been achieved or affords much possibility of achievement. See note 60 *supra* and text.

70. *Id.* § 608(c) (5). For products other than milk, the orders may limit the production of the commodity that may be marketed during any given period. *Id.* § 608(c) (6).

71. *Id.* § 608(c) (7) (C).

72. *Id.* § 671(a).

73. *Id.* § 608(b).

74. *Id.* § 671(d).

75. *United States v. Rock Royal Cooperative*, 307 U.S. 533, 560 (1939): "If the Act and Order are otherwise valid, the fact that their effect would be to give cooperatives a monopoly of the market would not violate the Sherman Act . . ."

76. *United States v. Borden Co.*, 308 U.S. 188, 198 (1939); *United States v. Maryland & Virginia Milk Producers Ass'n*, 179 F.2d 426 (D.C. Cir. 1949).

may be fixed under the marketing orders. If the machinery provided to administer the order is also utilized to fix prices charged consumers, there may be an unlawful conspiracy.⁷⁷

The promulgation of federal marketing orders is usually instigated by producers in the area,⁷⁸ and the order must be approved by two-thirds of the producers or by producers of two-thirds of the volume of the product in the area during a representative period.⁷⁹ Approval by a cooperative association is deemed to be approval by each of its members in determining the percentage of producers favoring adoption of the order.⁸⁰ Frequently, the order issued is modeled after a presently existing private marketing plan developed under the ægis of cooperative associations operating in the market.⁸¹ The combination of these factors presents the possibility of abuse. Certain of the orders are said to favor large producers and cooperatives which have sufficient numbers or volume to overcome the opposition of small groups who may be discriminatorily affected.⁸² As a special advocate within the structure of the government for farming interests, the Department of Agriculture cannot be expected to assume an impartial attitude in determining the fairness to all groups of its control programs. But, it should be alert to scotch inequities in the application of controls to the individual members of the group regulated. Further, the Department is the sole public agency, short of Congress, with authority to determine and rectify misuses of the marketing order system. As such, consideration should be given not only to the welfare of producers as a whole, but also to the interests of consumers and others that may be materially affected.

The Secretary of Agriculture is empowered to issue cease and desist orders against cooperatives qualifying under the Capper-Volstead Act when an association "monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural

77. 85 F. Supp. 622 (S.D. Ohio 1949), *aff'd per curiam*, 188 F.2d 959 (6th Cir. 1951).

78. See HOLMAN, ACTIVITIES OF THE NATIONAL MILK PRODUCERS FEDERATION 4 (Educational Series No. 42, 1952). Mr. Holman, Secretary of the Federation, attributes the disappearance of dealer resistance to the formation of milk cooperatives to the practice of the cooperatives in applying for and securing federal marketing orders. He also states that 44 milk marketing areas were operating under such orders at the end of 1951, and that the tendency has been to expand the area covered by each order. *Id.* at 22. The attractiveness of Federal Marketing Orders to milk cooperatives may be lessened by the recent decision in *Brannan v. Stark*, 72 S.Ct. 433 (1952). The Supreme Court held that provisions in the Boston area Order permitting payment to cooperatives from the equalization pool for services rendered only to members were not warranted by the statute.

79. 49 STAT. 753 (1935), as amended, 7 U.S.C. § 608(c) (8)-(9) (Supp. 1951).

80. *Id.* § 608(c) (12).

81. HOLMAN, *op. cit. supra* note 78, at 22.

82. See Note, 17 N.Y.U.L.Q. 86 (1939).

product is unduly enhanced by reason thereof.”⁸³ Apparently, this power has been rarely if ever exercised, and is co-existent with the duty of the Attorney-General to proceed against antitrust violations by cooperatives.⁸⁴

Certain other statutes, more specialized than the Sherman Act, may also be applicable to cooperatives. Section 1 of the Robinson-Patman Act,⁸⁵ amending Section 2 of the Clayton Act, in general prohibits price discrimination among different purchasers of commodities of like grade and quality not justified by cost differentials where the effect may be to substantially lessen competition or tend to create a monopoly.⁸⁶ There appears to be no basis for treating the cooperative entity, when acting as a buyer or seller, differently from other buyers and sellers in the market. Furthermore, agricultural cooperatives are not included in the specific exemptions from the Act, other than a provision that the Act is not to prevent a cooperative association from returning to its members net earnings in proportion to their sales to or purchases from the association.⁸⁷ Therefore, marketing cooperatives are precluded from charging such discriminatory prices, while purchasing cooperatives are forbidden to knowingly induce or receive them, where monopoly or reduction of competition is threatened.⁸⁸

Section 3 of the Clayton Act makes unlawful leases, sales or contracts for sale of commodities on the condition, agreement, or understanding that the purchaser or lessee will not deal in the goods of competitors of the seller or lessor, where the effect may be to substantially lessen competition or tend to create a monopoly.⁸⁹ The application of Section 3 to cooperatives may well depend upon the scope given to the Clayton and Capper-Volstead exemptions. Certainly, contracts with members requiring sale of their entire production through or to the cooperative are unaffected.⁹⁰ However, marketing cooperative contracts

83. 42 STAT. 388 (1922), 7 U.S.C. § 292 (1946).

84. *United States v. Borden Co.*, 308 U.S. 188, 204 (1939).

85. 49 STAT. 1526 (1936), as amended, 52 STAT. 446 (1938), 15 U.S.C. § 13 (1946).

86. See Fuchs, *The Requirement of Exactness in the Justification of Price and Service Differentials Under the Robinson-Patman Act*, 30 TEX. L. REV. 1 (1951), for an excellent commentary on some Robinson-Patman Act problems. See also, Dresbach, *Cooperatives and Some Aspects of the Robinson-Patman Act* in COOPERATIVE CORPORATE ASSOCIATION LAW-1950, 545 (Jensen ed. 1950).

87. 49 STAT. 1528 (1936), 15 U.S.C. § 13(b) (1946). See Bunn, *supra* note 23, at 171.

88. *Quality Bakers of America v. F.T.C.*, 114 F.2d 393 (1st Cir. 1940); *Rathke v. Yakima Valley Grape Growers Ass'n*, 30 Wash.2d 486, 192 F.2d 349 (1948). These cases are wholly in accord with the legislative intent. See, e.g., *Remarks of Representative Utterback on the Conference Report*, 80 CONG. REC. 9419 (1936).

89. 38 STAT. 731 (1914), 15 U.S.C. § 14 (1946).

90. These contracts only require the member-vendor to sell all his production to the cooperative, they do not limit the cooperative-vendee in its dealings with competitors,

requiring purchasers to obtain their full supply from the association are more vulnerable.

In *United States v. Maryland & Virginia Milk Producers Ass'n*,⁹¹ an indictment of a cooperative association, consisting of producers of 80% of the milk sold in the Washington, D. C., area, seven corporate milk distributors, and other individuals, was sustained against a motion to dismiss. The complaint alleged that contracts between the association and the distributors provided for the classified-utilization system of milk pricing⁹² and bound each distributor to purchase its full requirements from member producers assigned to it by the association as part of a conspiracy to eliminate and suppress competition in restraint of trade under Section 3 of the Sherman Act.⁹³ However, on appeal from the actual trial of the case, during which the defendant distributors were reduced to three handling 13.8% of the milk sales in the area, the Circuit Court held that the full supply contracts were not illegal in the absence of proof of a purpose to eliminate and suppress competition.⁹⁴ The opinion, written by the dissenting judge in the first case, gave a questionable interpretation to the previous decision⁹⁵ and apparently was influenced considerably by the economic usefulness of requirements contracts in the milk industry.

The validity of this decision is doubtful, even as to the Sherman Act.⁹⁶ But assuming that cooperative requirements contracts are without the coverage of the Sherman Act when reasonable, they may still be proscribed by Section 3 of the Clayton Act when a substantial part of the market is affected. The Supreme Court held such contracts to be illegal *per se* in *Standard Oil Co. of California v. United States*,⁹⁷ dispensing with proof of unreasonableness.⁹⁸

which would be necessary to come within the language of the Section. Moreover, such contracts are expressly authorized by the Capper-Volstead Act.

91. 179 F.2d 426 (D.C. Cir. 1949).

92. See note 66 *supra* for discussion of this aspect of the case.

93. 26 STAT. 209 (1890), 15 U.S.C. § 3 (1946). This Section applies the provisions of Section 1 to restraints on trade in or with the District of Columbia.

94. *Maryland & Virginia Milk Producers Ass'n v. United States*, 193 F.2d 907 (1951).

95. *Id.* at 918 (dissenting opinion).

96. See note 66 *supra*. But see *Whitwell v. Continental Tobacco*, 125 Fed. 454 (8th Cir. 1903); Lockhart and Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 938 (1952).

97. 337 U.S. 293 (1949). A later case to the same effect is *Richfield Oil Co. v. United States*, 72 S.Ct. 665 (1952).

98. For a general treatment of the requirement contracts question, see Lockhart and Sacks, *supra* note 96 at 913; McLaren, *Related Problems of "Requirements" Contracts and Acquisitions in Vertical Integration under the Anti-Trust Laws*, 45 ILL. L. REV. 141 (1950); Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil*

Unfair methods of competition in commerce violate Section 5 of the Federal Trade Commission Act.⁹⁹ Since the section encompasses many activities which also contravene the Sherman Act, its extension to cooperative practice of this type should depend upon whether the cooperative is subject to the latter statute.¹⁰⁰ However, "corporation" as used in the Act is defined to include associations, and there is no obvious intent or foundation for excluding cooperatives from strictures against misleading advertising, mislabeling, and similar deceptive practices.¹⁰¹

CONCLUSION

The antitrust laws at present are not a serious obstacle to cooperative activities. Infrequent prosecutions and favorable statutes and court decisions have afforded agricultural cooperative associations broad immunity from the state laws. The Sherman Act in conjunction with the other federal antitrust statutes may impose a considerable restraint on cooperatives in the future. The *Borden* case brings combinations and conspiracies with independent parties under the Sherman Act, and indicates that the exemptions of the Clayton and Capper-Volstead Act may be rather narrowly construed by the federal courts when the occasion arises.

However, as yet, attempts to enforce the federal antitrust laws against cooperatives are rare and restrictions on competition are often accomplished under the protective shield of a federal marketing order. In the long run, the relationship of the antitrust statutes to cooperatives will be determined by the attitude of Congress and the courts with respect to the maintenance of competition in agriculture, and the role allotted cooperatives in our national farm policy.

Co. of California v. United States on the Standard of Legality Under the Clayton Act, 98 U. OF PA. L. REV. 10 (1949).

99. 38 STAT. 719 (1914), as amended, 15 U.S.C. § 45 (1946).

100. *F.T.C. v. Cement Institute*, 333 U.S. 683, 690-693 (1948), reaffirms the rule that certain activities are encompassed by both the Sherman and Federal Trade Commission Acts and contains a resumé of the earlier cases. Under the theory of these cases, almost any conduct violating the other antitrust statutes would also run afoul of Section 5. "As early as 1920 the Court considered it an 'unfair method of competition' to engage in practices 'against public policy' because of their dangerous tendency unduly to hinder competition or create monopoly." *Id.* at 690, quoting from *F.T.C. v. Gratz*, 253 U.S. 421, 427 (1920). To the extent that these practices are "unfair competition" because they are against the policy of the other antitrust laws, any activity which is excluded from the coverage of those laws should no longer be considered "unfair."

101. See Chaffee, *Unfair Competition*, 53 HARV. L. REV. 1289 (1940); Notes, 42 ILL. L. REV. 384 (1947); 26 TEX. L. REV. 355 (1948).

It is specified that the association be organized as "farmers', fruit growers', or like associations."¹¹ Since the doctrine of *ejusden generis* is applied to this statutory phrase, it is settled that the terminology limits the exemption to cooperative agricultural associations which either purchase from or supply equipment to those engaged in producing agricultural products.¹²

The cooperative must operate as a marketing or purchasing agency on a cost basis, ultimately turning back all net proceeds to member and nonmember patrons.¹³ The Bureau of Internal Revenue has construed

<i>Non-Exempt</i>	<i>Exempt</i>
2. Must pay tax on such taxable income as:	2. Does not pay such taxes.
a. Non-operating or extraneous income or capital gains.	a. No tax. [must be allocated today.]
b. Reserved operating earnings.	b. No tax, but subject to limitations.
c. All operating earnings not distributed in prescribed manner.	c. Must allocate operating savings to all patrons on a patronage basis.
d. All earnings distributed as interest or dividends on capital stock.	d. No tax, but subject to limitations.
e. All earnings done for U.S. or its agencies, if not refunded to them.	e. May distribute to all other patrons or (sic) patronage basis.
3. Must purchase and affix excise stamps to certain documents.	3. Not required.
4. No Social Security preference.	4. Not required.
5. Must maintain each year its legal and corporate basis for excluding refunds from gross income.	5. Must adhere to requisites for exemption at all times during subject year.
6. May pay any rate of dividends or interest on capital shares (but is taxed on amounts so paid or accrued).	6. Rate is limited to state rate or 8%.
7. May have unlimited capital reserves (after income tax thereon is paid).	7. Must limit such reserves and allocate them to patrons on patronage basis.
8. Must maintain patronage records.	8. Must maintain patronage and allocation records. [Must file reports of patronage today.]
9. Owned and controlled by anyone.	9. Must be substantially controlled by producer-patrons.
10. May operate in part commercially and in part cooperatively.	10. Must operate 100% cooperatively.
11. May engage in any type of business.	11. Must adhere to requisites for exemption.
12. May do business with anyone.	12. Must adhere to requisites for exemption.
13. Regular two-year carry-over and carry-back provision on losses.	13. More flexible treatment for losses of any year.

11. See note 9 *supra*.

12. *National Outdoor Advertising Bureau v. Helvering*, 89 F.2d 878 (2d Cir. 1937); *Sunset Scavenger Co. v. Commissioner*, 84 F.2d 453 (9th Cir. 1936).

The Bureau of Internal Revenue has construed the term "like association" to include a farmers' cooperative organized to operate a roadside market for its members. See I.T. 2720, XII-2 CUM. BULL. 71 (1933).

13. See note 9 *supra*.

this requirement as applicable to associations which take title to the goods involved, as well as those functioning on an agency basis. Associations which process the producers' crops also are included.¹⁴ Moreover, a federated type cooperative may reap the benefits of the statute if it otherwise qualifies.¹⁵ If, however, an association is engaged in two distinct lines of business, such as the marketing of agricultural products for its members and the manufacture of farm machinery to be used by its members, it must qualify with respect to each phase of its activity.¹⁶

Substantially all stock except non-voting, non-profit-sharing preferred stock must be owned by producers or purchaser member patrons.¹⁷ The term "substantially all" is not susceptible of precise definition, but rather involves a question of fact which must be decided in light of the circumstances of each particular case. However, the Bureau has established a guide to aid in determining whether this prerequisite has been satisfied.¹⁸ It has stated that an association must explain any ownership of stock by other than actual producers, and must show that ownership of capital stock has been restricted in so far as possible to actual producers who market their products through the association. If the officers of an association are required by statute to be shareholders, the ownership of a share of stock by a nonproducer who serves as an officer, to fulfill the statutory requirement, will not destroy the exemption. Similarly, the exemption will not be lost if a shareholder ceases to be a producer under such circumstances that the association is unable to retire or purchase this stock for some cause beyond its control. However, if stock is voluntarily sold to nonproducers and no extenuating explanation is forthcoming, the exemption will be denied under the statute for the period that such stock is held. Generally, where a cooperative association, in good faith, attempts to restrict ownership of all its voting stock to producing member patrons, the privileges accorded by the statute will not be withheld.¹⁹ Presumably, the same considerations apply equally to both purchasing and marketing associations.

The fourth requirement is that dividends may not exceed eight per centum per annum, or the legal rate in the state of incorporation, whichever is greater.²⁰ This restriction is determined on the value of the

14. MIM. 3886, X-30-5150 CUM. BULL. 164 (1931).

15. I.T. 2000, III-1 CUM. BULL. 290 (1924).

16. MIM. 3886, X-30-5150 CUM. BULL. 164, 167 (1931).

17. See note 9 *supra*.

18. MIM. 3886, X-30-5150 CUM. BULL. 164 (1931).

19. *Farmers Co-operative Creamery v. Commissioner*, 21 B.T.A. 265 (1930).

20. See note 9 *supra*. See *South Carolina Produce Ass'n v. Commissioner*, 50 F.2d

consideration for which the stock was issued,²¹ and applies to stock and cash dividends, or a combination. It is not applicable to patronage dividends since those are issued, as the term implies, on the basis of patronage rather than stock ownership. Nor does the limitation apply where an association is unable to pay dividends during one year and later makes up this arrearage, either in one year or over a period, so long as the total paid does not exceed the prescribed amount for the entire period.²² The clarity of this requirement makes its administration relatively simple.

A cooperative may accumulate only those reserves required by state law, and other reasonable reserves for necessary business purposes.²³ Accordingly, treasury regulations permit the accumulation and maintenance of reasonable reserves for capital expenditures, such as the erection of buildings and facilities required in business or for purchase and installation of machinery and equipment.²⁴ Other necessary reserves may include provisions for depreciation charges,²⁵ overpayments to members,²⁶ bad debts,²⁷ possible loss from pending law suits, or other specifically anticipated contingencies.²⁸ However, reserves may not be accumulated, to any considerable extent, for activities which are not necessary to the sale of members' products.²⁹

Neither the cooperative nor its member patrons may realize a discriminatory advantage over nonmember patrons.³⁰ The Bureau has established a guide to aid in the application of this requirement.³¹ In

742 (4th Cir. 1931), where the association was denied an exempt status because it paid a 10% dividend.

21. In *Farmers Mutual Cooperative Creamery v. Commissioner*, 33 B.T.A. 117, 125 (1935), the court said: "Admittedly, in this case \$27,140 of the outstanding capital stock of \$45,680 was issued as stock dividends and the shareholders paid nothing therefor. This fact alone bars the petitioner from claiming exemption from income tax; for after the declaration of the stock dividends, the stockholders were receiving from 12 to 18 percent per annum on the amounts invested by them." Also see *South Carolina Produce Ass'n v. Commissioner*, 50 F.2d 742 (4th Cir. 1931).

22. HULBERT, *LEGAL PHASES OF COOPERATIVE ASSOCIATIONS* 254 (F.C.A. BULL. No. 50, 1942).

23. See note 9 *supra*.

24. U.S. Treas. Reg. 103, § 19.101(12)-1.

25. 6 MERTENS, *LAW OF FEDERAL INCOME TAXATION* 86 (1949).

26. In *San Joaquin Valley Poultry Producers' Ass'n v. Commissioner*, 136 F.2d 383 (9th Cir. 1943), it was held that the cooperative did not lose its exemption by setting up reserves for over payments to members since under California law these amounts belonged to members rather than the cooperative.

27. WAAS & WHITE, *APPLICATION OF THE FEDERAL INCOME TAX STATUTES TO FARMERS' COOPERATIVES*, 104 (F.C.A. BULL. No. 53, 1942).

28. *Ibid.*

29. *Burr Creamery Corporation v. Commissioner*, 62 F.2d 407 (9th Cir. 1932), *cert. denied*, 289 U.S. 730 (1933).

30. See note 9 *supra*.

31. MIN. 3886, X-2 CUM. BULL. 164, 166 (1931).

short, if the association markets products for nonmember producers, the proceeds of all business done less the ordinary deductions must be returned to the patrons without distinction between members and nonmembers.³² The cooperative may not make a profit on business transacted with nonmember patrons and divert the proceeds from the patrons entitled to them. However, if the cooperative satisfies the other requirements of the statute, but defers payment of patronage dividends to nonmembers, the association's preferential status will not be lost if the by-laws provide for payment both to members and nonmembers and a general reserve is created for the distribution to nonmembers. The result is the same where the by-laws are silent concerning payment to nonmembers, but a specific credit to each nonmember account is set up on the books of the association; or where the by-laws are silent, but it has been the practice to make payment to nonmembers; or where patronage dividends are payable only upon their accumulation to an extent sufficient to defray the cost of membership.³³ If the cooperative is operated in such a manner so as to meet the requirement of the statute regarding equality of treatment between member and nonmember patrons, the presence of charter powers permitting discrimination will not cause the association to lose the benefit of the statute.³⁴ This requirement of equal treatment leads some members to question the advantages of membership since nonmembers are entitled to substantially the same rights and privileges.³⁵ However, only members may control the organization, formulate its internal policy, and determine with whom the association will transact its business.³⁶

Finally, it is required that nonmember business must not exceed member business and furthermore, purchasing cooperatives are limited in their purchases for nonmember nonproducer patrons to fifteen percent of their total business.³⁷ Compliance with this requirement is determined

32. I.T. 1914, III-1 CUM. BULL. 287 (1924).

33. *Ibid.*

34. In regard to the general problem of discrimination between member and nonmember patrons as to distribution or allocation of earnings see *Fertile Cooperative Dairy Ass'n v. Huston*, 119 F.2d 274 (8th Cir. 1941); *Farmers Cooperative Co. of Wahoo, Neb. v. United States*, 23 F. Supp. 123 (Ct. Cl. 1938); *Council Bluffs Grape Growers Ass'n v. Commissioner*, 44 B.T.A. 152 (1941); *Farmers Mutual Cooperative Creamery v. Commissioner*, 33 B.T.A. 117 (1935); *Central Cooperative Oil Ass'n v. Commissioner*, 32 B.T.A. 359 (1935).

In addition to the prohibition as to discrimination between members and nonmembers, *Farmers Union Cooperative Oil Company v. Commissioner*, 38 B.T.A. 64 (1938) held that the exemption may be denied because of discrimination between actual members.

35. See *WAAS & WHITE*, *op. cit. supra* note 27, at 57.

36. In addition to the factors named the members of these organizations also receive dividends upon the stock which they hold in the association.

37. See note 9 *supra*. In *Producers Livestock Marketing Ass'n of Salt Lake City*, 45 B.T.A. 325 (1941), it was held that where the articles of an association restrict

by dollar amounts of business transacted with nonmember nonproducers and not by unit volume of product or the number of patrons in each classification.³⁸ Certain types of activity on the part of a cooperative association do not fall within the classification of nonproducer business.³⁹ Such is true of any business transacted with the United States Government or any of its agencies, for the statute specifically eliminates such business for purposes of establishing the right to its privileges.⁴⁰ Also, if the cooperative processes the goods of the member before marketing them, it is doubtful that the purchase of ingredients to be added to the basic product would be considered as nonmember nonproducer business.⁴¹

Cooperative associations have periodically advanced a series of arguments to justify their favorable position in regard to federal taxation. One such argument is predicated on an analogy drawn from the law of agency.⁴² The agency theory of exemption arose under the provisions of the early Revenue Acts which regarded cooperatives as sales agents for their members.⁴³ At this particular time many of the associations actually operated in such a manner. This relationship between the association and its members, however, had inherent limitations which made it difficult to market various types of produce for a large number of producers and continue to function as a true agent.⁴⁴ More and more the cooperatives found it advantageous to take absolute title to the goods, to commingle them in common storage facilities, and thus to conduct their operations in a manner similar to other business entities with which they were forced to compete.⁴⁵ It was no longer possible to account individually with each member as an ordinary principal-agent relationship requires. Moreover, the financial requirements of the typical producer-member made it impossible for him to prolong the return of his crop investment until his produce was eventually sold on the market. For this reason it became expedient for the association to make payment

membership to common stockholders, and the cooperative does a greater volume of business with nonmembers than with members, the association is not entitled to the exemption. See Cooperative Central Exchange, 27 B.T.A. 17 (1932); U.S. Treas. Reg. 111, § 29.101 (12)-1.

38. See WAAS & WHITE, *op. cit. supra* note 27, at 99.

39. I.T. 1914, III-1 CUM. BULL. 287 (1924).

40. See note 9 *supra*.

41. See HULBERT, *op. cit. supra* note 22, at 260.

42. See Magill and Merrill, *The Taxable Income of Cooperatives*, 49 MICH. L. REV. 167, 184 (1950).

43. Revenue Act of 1924, § 231(11), 43 STAT. 282 (1924); Revenue Act of 1921, § 231(11), 42 STAT. 253 (1921); Revenue Act of 1919, § 231, 40 STAT. 1076 (1919); Revenue Act of 1913, § 116(a), 38 STAT. 172 (1913).

44. See PART III, pp. 421-423 *supra*.

45. *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 215 (N.D. Iowa 1949).

in advance and take title to the goods before marketing them, or in some instances even prior to delivery from the producer.⁴⁶

Congress in 1926 recognized the change which had transpired and deleted the requirement that cooperatives must operate as sales agents to qualify under the statute.⁴⁷ And in 1932 the Treasury abandoned the agency theory by ruling that under the Revenue Acts of 1916, 1917, and 1918, cooperative organizations which did not act as agents for their patrons, and which therefore were not exempt under the then existing law, were nevertheless authorized to deduct patronage dividends from gross income.⁴⁸

Occasionally cooperatives continue to maintain, despite the fact that the Code does not presently require them to assume the position of agents, that the statutory benefits accorded them are justified as they are merely the agents of their members or mere conduits of the funds of their members.⁴⁹ The courts generally have denied this assertion unless the facts of the particular case substantiate the claim after an inquiry into the real substance of the relationship involved. One pre-1926 decision, involving such an argument is *Cooperative Central Exchange v. Commissioner*,⁵⁰ where the court recognized that cooperatives may not operate in fact, as a true agent:

... [u]nless it is shown that titles to the farm products marketed through the petitioner remained in the producers thereof until sales were effected by it, we think the conditions contemplated by Congress and prescribed by the statutes are not satisfied. If the member cooperatives bought commodities from its producing members and resold them to petitioner for further sale to the public, it could hardly be argued that petitioner acts as agent for the producers. In our opinion the petitioner

46. For an excellent discussion of this point see Adcock, *Patronage Dividends: Income Distribution or Price Adjustment*, 13 LAW & CONTEMP. PROB. 505, 520 (1948). Another fundamental characteristic of agency is lacking, as the cooperative has no right of reimbursement or indemnity for loss resulting from transactions with a member. Accordingly, when Southern States Cooperative sustained an investment loss of one million dollars because of an unprofitable subsidiary, as disclosed in its annual report for the year ending June 30, 1950, there was no doubt that this loss fell directly upon the cooperative, not upon its members. See *Hearings before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1492 (1951).

47. Revenue Act of 1926, § 231(12), 44 STAT. 40 (1926).

48. I.T. 1499, I-2 CUM. BULL. 189 (1932).

49. "It is often said that a cooperative, particularly a marketing cooperative, is the agent of its producer members, and sometimes it is said that this is the reason for this rule of exclusion. But I think that is greatly oversimplifying the matter, and hardly a correct statement." Statement by Mr. Karl Loos, a representative of several well-known cooperative associations. *Hearings before Committee on Ways and Means on Revenue Act of 1950*, 81st Cong., 2d Sess. 2207 (1950).

50. 27 B.T.A. 17 (1932).

has failed to prove that any of the members are producers or producers' marketing agents within the meaning of the statutory provisions granting tax exemption to farmers' cooperatives.⁵¹

The court further discussed the factual aspects of the case, concluding that this particular cooperative was no more an agent of its members than any other wholesale merchant engaged in selling supplies which are ultimately consumed by producers.

Taxable corporations have attempted to utilize the agency device to limit their tax liability. This was the controversy in the recent case of *Railway Express Agency v. Commissioner*,⁵² involving an attempt by the Railway Express Co., a corporation, to limit its liability through an express contractual agency agreement with its railroad owners. The issue was whether or not the petitioner was taxable on the resulting increase in net operating income through the disallowance of certain deductions taken for depreciation. The Agency contended that it was not liable for the additional tax as the mere agent of the owner railroads, and contractually obligated to account to the owners for this amount. After considering the true substance of the relationship, the court denied this contention, holding the increase taxable and stating that *if a corporate device is used for business advantage* there is no just ground for protest when it results in tax liability.⁵³ The decision illustrates that courts will give credence to the agency device for reduction of tax liability only when it appears that a true agency relationship is present.⁵⁴

The trustee theory presents an alternative basis upon which co-operatives endeavor to vindicate their favorable tax position.⁵⁵ The

51. *Id.* at 20.

52. 169 F.2d 193 (2d Cir. 1948), *cert. denied*, 336 U.S. 944 (1949).

53. *Id.* at 196.

54. In a recent case, *National Carbide Corporation v. Commissioner*, 336 U.S. 422 (1949), petitioners claimed a reduction in their income and excess profits taxes on the theory that, by virtue of a contract with their controlling (Airco) corporation, they were only agents of Airco to the extent of all their earnings in excess of expenses and a six percent payment on their outstanding capital stock. The Court denied these claims, holding that complete ownership of the subsidiary corporation and the control primarily dependent upon such ownership are no longer of significance in determining taxability. The Court also pointed out that the existence of the "agency contracts" requiring petitioners to pay all their profits above a nominal return to Airco did not conclusively determine that the income "belonged to Airco."

55. See *Rhodes v. Little Falls Dairy Co.*, 245 N.Y. Supp. 432, 434 (1930), *aff'd*, 256 N.Y. 559, 177 N.E. 140 (1931), where the court said, "We do not agree with the Special Term that the contract is the ordinary one of purchase and sale. Even though title may have passed, still the arrangement is for co-operative marketing. The status of the parties partakes of a trust or fiduciary character, and is not the simple relation of vendor and vendee; the fund derived from the marketing of the product being subject to distribution among the various producers, sales of whose product had gone to make it up."

rationale of this view is that the money received by the association from its business transactions is in the nature of a fund of which the manager and directors of the association are the trustees, while the patrons are beneficiaries.⁵⁶ The cooperative, in its capacity as trustee, is authorized to deduct from the fund amounts for necessary expenses and return the balance to the patrons. This theory is subject to criticism as being unrealistic when superimposed upon the actual business procedures currently employed by most cooperatives.⁵⁷ In addition, this reference to a trust relationship actually does not support the cooperative in justifying its preferential tax treatment. For trusts which engage in ordinary business activities, as distinguished from trusts which merely receive income for distribution to the beneficiaries while exercising no managerial function, are classified as business associations and are subject to the regular corporate tax rates.⁵⁸

The essence of a third position is that a deduction for tax purposes of patronage refunds, the principal source of controversy over the grant of tax advantage to cooperatives, is available not solely to cooperative associations, but that any business entity which chooses to refund to customers on the basis of patronage may deduct such refunds for tax purposes. However, the practical impossibility of this choice is obvious, since other business entities generally never find it expedient to operate in such manner. A corporation which distributed its earnings to customers instead of shareholders would have little reason to exist. Indeed, the earnings of any privately owned business are of necessity distributed to its owners. That the owners of a cooperative are at the same time its customers renders the cooperative method of business unique but furnishes no meaningful distinction upon which to predicate exemption.

Finally, there is advanced the price adjustment or rebate theory by those who favor special treatment for cooperatives taxwise.⁵⁹ This proposition admits that the association buys and takes title to the member producers' product and later sells it again on the market. However, it is asserted that there is no real income to the association, since the amount returned to the patron on the basis of the business transacted with the organization is a refund or rebate, equivalent to an adjustment of the initial price paid the member for the product.⁶⁰ There would be

56. See *California & Hawaiian Sugar Refining Corp., Ltd. v. Commissioner*, 163 F.2d 531, 533 (9th Cir. 1947), *cert. denied*, 332 U.S. 846 (1948).

57. See PART II, *supra*.

58. See *Morrissey v. Commissioner*, 296 U.S. 344 (1935); *Hecht v. Malley*, 265 U.S. 144 (1924).

59. For a discussion of this theory see Adcock, *supra* note 46.

60. See Sowards, *Should Co-ops Pay Federal Income Taxes*, 19 TENN. L. REV. 908, 914 (1947).

valid basis for this argument if the cooperative actually operated in this manner. However, such an organization usually does not refund to any one member solely upon the basis of what he has contributed to the enterprise.⁶¹ It is entirely possible that a patron may furnish produce to the association upon which it will suffer a loss due to fluctuating market conditions.⁶² Subsequently, other members may deliver produce which are marketed at a sufficiently high price to enable the cooperative to close the season with a net margin, making possible the payment of a patronage refund. The member furnishing the crops which the organization marketed at a loss would, despite the loss on his products, receive a patronage refund. In fact, if he delivered a greater volume of the particular commodity than other producers, he would receive a proportionately greater refund than the amount paid to the smaller, yet profit producing, patron. Sums returned to a member are thus not directly related to profits realized on the sale of his particular products but to profits on the marketing of all the members' products. The court in *Maryland and Virginia Milk Producers' Association v. District of Columbia*⁶³ was aware of this averaging principle when it stated that the cooperative sells for its own account and not for that of the member.

That a cooperative earns income seems difficult to dispute. It has assets and employees; it buys, sells, and performs services. The Supreme Court in *National Carbide Corporation v. Commissioner*⁶⁴ recog-

61. A general analysis of the business operations of cooperatives reveals the impracticability if not the impossibility of relating patronage dividends to gain or loss upon any particular transaction with any particular patron. "To say, in effect, that a sale remains open until the end of an accounting period to permit the payment of an addition to the price does not recognize facts. For example, during 1946 there were extremely wide fluctuations in the price of flaxseed, the price increasing from \$3.00 to \$6.00 per bushel in just a few days. Many farmers sold flaxseed to cooperative grain elevators both before and after the price increase. In the case of a farmer who before the price increase sold flaxseed which the cooperative sold after the price increase, the theory that the formal sale was not closed but was in fact open pending receipt of the additional price would require that an additional payment of almost \$3.00 per bushel be made. The farmer who had received \$6.00 initially and whose flaxseed was sold by the cooperative at \$6.00 plus freight and margin would not be entitled to receive additional payment. But cooperative corporations do not return to each farmer the net proceeds of the sales of his produce less necessary expenses; instead, they determine the over-all net profits for flaxseed and these profits are shared by all flaxseed patrons in proportion to their patronage." Adcock, *supra* note 46, at 520-21.

62. Another example of how an individual member's transactions may result in loss to the enterprise is in the case of a purchasing cooperative where the member only purchases "loss leaders." Nevertheless, the member may receive a distribution based on profits gained in another, wholly unrelated segment of the business. Moreover, where the interval between members' transactions and distributions is protracted, the "margin" distributed may be almost entirely attributable to inventory appreciation, resulting from over-all economic inflation. See *Hearings before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1494 (1951).

63. 119 F.2d 787 (D.C. Cir. 1940).

64. 336 U.S. 422 (1949).

nized that funds derived from business enterprise are the profits of the organization owning the assets, employing the workers, and carrying out the commercial activities, even though a parent corporation has a legally enforceable claim to those funds. The economic realities of such a situation received full recognition by the Court in the *Carbide* case when it called attention to the petitioner's claim that they were only taxable on net income aggregating \$1,350, despite the fact that during the taxable year they owned assets worth twenty million dollars and earned nearly four and one-half million dollars net.⁶⁵

Beyond question, Congress has the power to tax cooperative associations, for the power of federal taxation is extremely broad. The Supreme Court has held that the subject matter of taxation open to the power of Congress is as comprehensive as that open to the power of the states,⁶⁶ and includes every form of tax appropriate to sovereignty. Perhaps the leading case defining income since the Sixteenth Amendment is *Eisner v. Macomber*,⁶⁷ where the Court first expounded its philosophy regarding the true scope of the federal taxing power. Not only may Congress determine what income shall be subject to tax, but has an equally broad power to determine to whom it may be taxed.⁶⁸ Congress exercised its prerogatives in the Revenue Act of 1951, where it modified⁶⁹ the scope of the tax immunity granted to agricultural cooperatives.⁷⁰

Subparagraph (B) of IRC Section 101(12), initially abolishes the exemption, subjecting all cooperatives to the regular corporation tax rates.⁷¹ If, however, such an organization can qualify under the prior

65. *Id.* at 438.

66. *Steward Machine Company v. Davis*, 301 U.S. 548 (1937).

67. 252 U.S. 189 (1920).

68. *Burnet v. Wells*, 289 U.S. 670 (1933).

69. See note 9 *supra*; note 71 *infra*.

70. *Penn Mutual Life Insurance Company v. Lederer*, 252 U.S. 523 (1920), is the only case concerning the constitutional taxability of cooperatives which has been before the Supreme Court. The Court there held that the fact that the investment resulting in accumulation is made by a cooperative as distinguished from a corporate concern does not prevent the amount from properly being classified as a profit on the investment. The Court also noted that the fact that this profit was earned by a cooperative did not afford basis for the argument that Congress did not intend to tax the ensuing profit. In other related fields of income taxation, the Court has held that the substance or true manner in which the taxpayer conducts his business, and not the legal form which he might adopt determines the manner in which he will be taxed. See *Burk-Waggoner Oil Association v. Hopkins*, 269 U.S. 110 (1925), where the Court held that Congress had the right to tax as a corporation a "Massachusetts trust" which was technically a partnership under state law. The same principle is illustrated in the family partnership cases, *Commissioner v. Lusthaus*, 327 U.S. 293 (1946); *Commissioner v. Tower*, 327 U.S. 280 (1946); *Commissioner v. Harmon*, 323 U.S. 44 (1944).

71. "(B) An organization exempt from taxation under the provisions of subparagraph (A) [the original exemption provision under section 101 (12)] shall be subject

requirements prescribed in subparagraph (A), it becomes entitled, by virtue of part B, to *two* important deductions not available to associations previously termed non-exempt, *i.e.*, those which do not meet the seven prerequisites of 101(12)(A).⁷² These constitute deductions for dividends paid on capital stock and for amounts allocated during the taxable year with respect to income not derived from patronage.⁷³ A deduction for amounts paid to patrons during the taxable year as patronage refunds is available to all cooperatives, regardless of compliance with 101(12)(A).⁷⁴ In addition to these special privileges, an

to the taxes imposed by sections 13 and 15 [the regular corporate tax rates imposed by the Revenue Act of 1951], or section 117 (c) (1), [capital gains] except that in computing the net income of such an organization there shall be allowed as deductions from gross income (in addition to other deductions allowable under section 23)—

(i) amounts paid as dividends during the taxable year upon its capital stock, and

(ii) amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving funds certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to income derived before the close of such year.

Patronage dividends, refunds, and rebates to patrons with respect to their patronage in the same or preceding years (whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount of such dividend, refunds, or rebate) shall be taken into account in computing net income in the same manner as in the case of a cooperative organization not exempt under subparagraph (A). Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year."

72. *Ibid.*

73. *Ibid.* See WAAS, RECENT FEDERAL INCOME TAX CHANGES AFFECTING COOPERATIVES 2 (F.C.A. MISC. REPORT No. 156, 1951).

74. *Ibid.* Senator George interpreted Section 101(12)(B) to the effect, "Patronage allocations by cooperatives are not income to the cooperatives under this section, but are excluded from gross income of the cooperative organization." 97 CONG. REC. 12202 (Sept. 24, 1951).

In the case of a non-exempt association, an exclusion from a cooperative's gross income of "patronage dividends" has been permitted by Treasury Department rulings and decisions by some lower federal courts. See *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 206 (N.D. Iowa 1949). Some writers feel that litigation under Section 101(12) of the Code with respect to absolute exemption will be greatly decreased in the future, and in turn litigation concerning the exclusion of patronage refunds will be greatly increased. Generally speaking, for a patronage refund to be excludable from a cooperative's gross income it must be based upon a legal obligation to pay, growing out of a pre-existing enforceable contract. See *Cooperative Oil Association v. Commissioner*, 115 F.2d 666 (9th Cir. 1940), where the court impliedly disapproved of the practice of the Bureau of permitting the deduction of patronage dividends paid at the discretion of the board of directors. See also *American Box*

organization which qualifies under the statute may take all of the deductions generally available to any taxable corporation under Section 23 of the Code.⁷⁵

Interpretation by judicial decision or treasury regulation will be necessary of course, to ascertain fully the impact of the 1951 amendment. Under the previous statutory provisions the term capital stock, with reference to the payment of dividends, was construed broadly to include any type of capital, including such sources as debentures. There is no indication that Congress intended a different meaning; this interpretation may well be carried into effect under the new provisions. A more significant problem concerns the deductibility of dividends. If a dividend actually has been paid to stockholders there is no difficulty. And even where there has been only an accrual, its deduction should not become subject to question if the cooperative operates consistently on the accrual method and the dividend has been declared by the board of directors, whereby a legal obligation has been created. The principal question regarding dividends arises in connection with the federated cooperative organizations where dividends on capital stock are distributed to member cooperative associations. If the federated cooperative has satisfied the qualifications of Section 101(12)(A), such dividends would be deductible; but as to the association receiving the dividend a different aspect of the problem is presented. Such dividends amounts channeled to members would appear to be deductible as amounts allocated in respect to income not derived from patronage. If they were not so allocated the question arises whether they would be subject to the full corporate tax rate, or whether the member cooperative might compute a credit against its net margin for eighty-five percent of the dividends received in accordance with section 26 of the Code applicable to regular corporations. The answer is not certain, but there is substantial authority that Congress did not intend the benefits of section 26 to be available to farmers' cooperatives.⁷⁶

Shook Export Ass'n v. Commissioner, 156 F.2d 629 (9th Cir. 1946), where the court denied the exclusion of patronage dividends because there was not a legally binding contract which required their payment. In *United Cooperatives, Inc. v. Commissioner*, 4 T.C. 93 (1944), the court included within the petitioner's gross income that amount of the patronage refund which might have been paid as dividends upon capital stock.

For an excellent discussion concerning the exclusion of patronage dividends from the gross income of a cooperative see Hensel, *Taxation of Cooperatives* in COOPERATIVE CORPORATE ASSOCIATION LAW (Jensen ed. 1950).

75. See WAAS, *op. cit. supra* note 73, at ¶ 14.

76. INT. REV. CODE § 26(b). Supplemental Report No. 781, part 2, of the Senate Finance Committee at page 30 states that where a cooperative is found subject to the tax under section 314, it is nevertheless "to be considered exempt from income tax for the purpose of any laws which refer to an organization exempt from income tax. Accordingly, such code provisions as Section 26(a) (credits for dividends received

The deductions available under Section 23 of the Code must also be taken into consideration, for today all cooperatives, regardless of whether they meet the requirements of 101(12)(A), must concern themselves with such items as reasonable reserves for depreciation and bad debts, pension plans, and self-insurance as well as all other questions in this area facing any taxable corporation. It is now required that all pension plans be submitted to the Commissioner for approval before they may constitute a deductible expense.⁷⁷ In the past, taxable corporations which have maintained self-insurance funds have found them to be non-deductible and undoubtedly the same will apply in the case of cooperatives. But as the new Revenue Act is not retroactive concerning these associations, such an organization could change to another plan for insurance protection if a deduction for this type of expense were found to be desirable.

The new act imposes upon cooperatives the necessity of analyzing each expense and reserve for which a deduction is sought to insure that it is reasonable in amount and comparable to those allowed to other similar taxable business entities. For if such deductions are disallowed as unreasonable for tax purposes, the consequences may include not only a greater tax liability, but also a complete loss of the special privileges accorded under 101(12)(B). To take advantage of subparagraph B of Section 101(2) of the Code, a cooperative must meet the requirements of subparagraph A; and one such requirement is that reserves be reasonable. Therefore, a judicial determination that a reserve would not be allowable as a deduction under Section 23 of the Code may also constitute a finding that it is not a reasonable reserve within the meaning of 101(12).

In respect to reserves for depreciation, certain cooperative associations, formerly exempt, may be faced by a dilemma stemming from past tendencies to both under and over depreciate assets. In the case of under depreciation, some adjustment may be required to prevent the gaining of a tax advantage under the new Act. The problem of past over-depreciation presents a somewhat more difficult question. For during the years of over-depreciation, even though the cooperative itself was not particularly benefited taxwise, the patrons received a tax benefit in respect to their personal returns because patronage refunds were correspondingly decreased. The question certain to arise is whether or not such a cooperative may set its house in order and adjust the value of

from a domestic corporation which is subject to tax) and Section 141 (dealing with consolidated returns) do not apply to cooperatives taxable under Section 101(12)(A)." U.S. Treas. Reg. 111, § 29.101(12)-1 is the applicable Treasury Regulation.

77. See Comment, 27 IND. L.J. 59 (1951).

its assets to reflect their true worth. Even if such an adjustment were not permitted, there is no reason why the amounts which normally would be charged to depreciation could not be allocated to patrons under the provisions of the new Act and thereby place the tax burden upon those who had formerly received the tax advantage resulting from over depreciation.

The 1951 amendment indicates a distinct effort to narrow the tax advantage accorded cooperatives.⁷⁸ Basically, however, and despite some need for administrative clarification, there seems to be little change in their tax liability. In substance the exemption is still available in the form of deductions allowed upon compliance with the original seven prerequisites for exemption; and apart from those requirements, all cooperatives are allowed a deduction for patronage refunds. It is these deductions, particularly those allowed for amounts allocated to patrons, which enable cooperatives to attain their favorable tax position.

The justification for special treatment taxwise has been the peculiar objectives which cooperatives have sought to achieve. These associations have served a vital function in the economy by constituting for farmers an instrument of effective bargaining strength in their contact with other private businesses.⁷⁹ Previous to the development of the cooperative movement farmers generally were forced to purchase equipment and supplies at a price set by the seller, and to sell their products at a price set by the buyer.⁸⁰ Cooperation tends to alleviate this situation by enabling farmers to exert their combined influence over the market, and thus determine to some extent the prices to be received for their commodities and those to be paid for equipment and supplies. While this movement was in a stage of development, special protection was needed and Congress properly granted assistance in the form of exemption from federal income taxation. The present controversy revolves around the question of whether the continued extension of such assistance is warranted.

From present statistics which are available, it is apparent that some cooperatives have experienced vast growth since the original granting of the exemption, and in certain instances cooperative associations have be-

78. The 1951 amendment has the effect of getting all of this income into the tax stream at least once, whether on the part of the cooperative or in the return of the individual patron. Previously that amount designated as "reasonable reserves" completely escaped taxation, either to the patron or to the cooperative. This is the real significance of the new act in regard to this particular area.

79. See PART I, pp. 373-374 *supra*.

80. See *Hearing before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1419 (1951).

come big business.⁸¹ The 1947-48 survey of farmers' cooperatives compiled by the Department of Agriculture shows that for this period these associations had a total aggregate volume of business of \$8.6 billion, of which \$7.2 billion represented farm products marketed.⁸² This survey also pointed out that, while a great majority of the reporting cooperatives were small organizations, a large percentage of the volume of business done was accounted for by 656 large scale associations operating on a regional or even a nation-wide basis.⁸³ The expansion indicated by these statistics has not been shared equally by all cooperatives, for figures available for the years 1942-43 reveal that forty-eight federated or centralized regional cooperatives, each with a business volume of more than ten million dollars, accounted for about forty-three percent of the total volume of marketing done by cooperatives.⁸⁴

While the causal effect of the tax exemption upon the growth of certain cooperatives is incapable of exact determination, it would seem that the favorable tax treatment logically has provided these associations with some competitive advantage. The advantage is not reflected in the price at which these organizations sell their goods, but is utilized to secure

81. In 1946 there were 6,009 cooperatives which qualified for exemption under Section 101(1) of the Code.

Typical examples of cooperative enterprise on a large scale are: in fiscal year 1943-44 the California Cooperative Orange Growers paid \$11 million for the lumber town of Westwood and 100,000 acres of timber land, thereby acquiring a new source of wood for packing cases for Sunkist citrus fruits. The Dairymen's League completed plans for a \$650,000 milk plant in New York City. Southern States Cooperative paid \$300,000 for the Richmond, Virginia Trust Building. And New York's G.L.F. gave Cornell University \$200,000 for its school of nutrition. See *Big Business Without Profit*, 32 FORTUNE 152 (1945).

82. Farmers' marketing and purchasing associations: Estimated number of associations and business done for specified periods, 1913 to 1947-48.

(Money figures in millions)				
Periods	Number of associations	Marketing	Purchasing	Total
1913 -----	3,099	\$ 304.4	\$ 5.9	\$ 310.3
1921 -----	7,374	1,198.5	57.7	1,256.2
1925-26 -----	10,803	2,265.0	135.0	2,400.0
1930-31 -----	11,950	2,185.0	215.0	2,400.0
1935-36 -----	10,500	1,586.0	254.0	1,840.0
1940-41 -----	10,600	1,911.0	369.0	2,280.0
1945-46 -----	10,150	5,147.0	923.0	6,070.0
1947-48 -----	10,135	7,195.0	1,440.0	8,635.0
1948-49 -----	10,075	7,297.6	2,022.4	9,320.0

Source: STATISTICS OF FARMERS' MARKETING AND PURCHASING COOPERATIVES, 1947-48. Farm Credit Administration, U.S. Department of Agriculture, 1950.

83. TAX TREATMENT OF COOPERATIVES, PART 2, p. 3, by Staffs of the Treasury and the Joint Committee on Internal Revenue Taxation (Apr. 1951).

84. *Ibid.*

a large source of reserve capital, permitting their very rapid expansion.⁸⁵ It is interesting to note that the gross income of farmers' cooperative associations in 1945 was \$5.65 billion and for 1949 it was \$9.3 billion.⁸⁶ Thus, in four years the percentage increase has been 65 percent or an average of approximately 16 percent per year. While in theory the savings or net margins of cooperatives are returned to their members in the form of patronage dividends, such has not always been the case. From the information available for 1946, it appears that exempt cooperatives with gross receipts of \$50,000 or more had aggregate net margins, before patronage dividends or other distributions to members, of \$140 million. The breakdown of this amount shows \$28 million specifically set aside for reserves, six million dollars paid as dividends on capital stock, and \$106 million paid as patronage dividends. In respect to this latter amount, however, approximately \$16.5 million only was paid in cash, with the remainder credited to members as patronage dividends but not actually distributed.⁸⁷ Therefore, of the aggregate net margins of \$140 million, approximately \$118 million was retained for working capital, capital expenditures, and reserves. And under present internal reserve provisions, the entire amount would be allowed as a deduction for tax purposes.

Clearly, the question of whether the special treatment accorded cooperatives taxwise can be presently justified must continue to be answered with reference to the function which cooperatives perform. Their legitimate objective, to constitute an instrument of economic and

85. The advantages which the exemption permits may best be illustrated by a specific example. First, it must be remembered that an exempt cooperative pays no federal income tax. Consumers Cooperative Association of Kansas City, Missouri, does not fall within the exempt status but has the privilege of deducting patronage dividends from their net margins for tax purposes. This organization in 1948 paid federal income taxes of \$400,000 on an aggregate of total business transacted of \$55,000,000, and if they had paid on the same basis as competing corporations, they would have been obligated to pay approximately \$2,000,000. *Hearings before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1260 (1951). Their patronage dividends paid in cash for the same year were \$62,134 out of a total net savings of \$8,019,160. See, 1948 AND 1949 HANDBOOK ON MAJOR REGIONAL FARM SUPPLY PURCHASING CO-OPERATIVES 10 (F.C.A. MISC. REF. 1950). Converting these figures to percentages, it appears that this cooperative earned 14.5 percent on total sales and 61.5 percent on total patrons equity which would be the equivalent of invested capital in an ordinary corporation.

The same cooperative built a 3,400-barrel oil refinery at Phillipsburg, Kansas, several years ago. Out of its tax free earnings it was able to pay for the entire plant in about two years, although an average taxpaying company, building the same refinery, might well have required from ten to fifteen years to this capital expenditure. Sowards, note 23 *supra*, at 921.

86. The general inflationary trend which occurred during this period must be considered.

87. See TAX TREATMENT OF COOPERATIVES, *op. cit. supra* note 83, at 4.

socio-psychological benefit to farmers, cannot reasonably be questioned. The crux, then, is whether tax privileges are necessary to continued achievement of this goal. Cast inevitably into this mold, the inquiry is solely a matter for legislative policy judgment,⁸⁸ aided in part by an analysis of the present relative efficiency, capital requirements, and economic strength of cooperatives.

The issue should not be confused by pleas for symmetry in the tax laws, nor by indignant reference to inequality of treatment. Neither is it relevant to engage in the fiction of classifying the cooperative as an agent, or a trustee, or to assert that it is a mere conduit of funds with no income of its own. Such arguments are meaningless in themselves, and they further have the effect of speciously concealing the only valid approach to a solution of the cooperative tax problem.⁸⁹

A provision of the new internal revenue act requires cooperatives to submit detailed and comprehensive reports concerning certain aspects of their financial affairs.⁹⁰ In accordance with the notion that their

88. See Packel, *Cooperative and the Income Tax*, 90 U. OF PA. L. REV. 137 (1941).

89. The confusion in the entire field can best be illustrated by the manner in which the cases and writers attempt to deal with some of the problems. Where under the applicable state statutes a cooperative is authorized to act both as agent and purchaser, the parties may expressly adopt by agreement and practice the seller-purchaser relationship in order to secure economic advantages. See *Clinton Co-op. Farmers Elevator Ass'n v. Farmers Union Grain Terminal Ass'n*, 223 Minn. 253, 26 N.W.2d 117 (1947). Writers have also argued that the cooperating members are the real parties in interest in any transaction undertaken by the association; that the cooperative is a legal entity and takes legal title to goods in order to adapt itself to the usages of trade and that this legal title preserves the rights of members and exists only for a special and limited purpose, i.e., for the benefit of those who deal with the association in good faith and in the normal course of business. Henderson, *Cooperative Marketing Associations*, 23 COL. L. REV. 91 (1923); Note, 23 NOTRE DAME LAW 342 (1948). Also see O'Meara, *The Federal Income Tax in Relation to Consumer Cooperatives*, 26 ILL. L. REV. 60 (1941).

90. Section 314 further provides: "Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year." See note 71 *supra*. In view of the statutory language three connotations of this section are possible. First, since no other reporting date has been prescribed, it may be assumed that all such organizations will operate on a calendar year reporting on March fifteenth in accordance with Section 53 of the Code, with the privilege of amendment concerning patronage dividends attributable to patronage during the taxable year until the fifteenth day of the ninth month. The second possible interpretation is in view of the language "such taxable year" in the statutory provisions that such an organization may operate either on a calendar or fiscal year and follow the procedures outlined above. Third, this section may also be construed in effect that the reporting date shall be the fifteenth day of the ninth month for all cooperative associations qualifying under the section. This interpretation would provide the greatest ease of administration; however, the ambiguousness of the language will permit the Commissioner to use discretion in selecting the method which presents the greatest ease of administration for both the Bureau and the organizations falling under the section.

In regard to this problem Senator George has said: "... the bill as it was pre-

tax position presents a legislative problem only, it is suggested that the ready availability of data taken from this source might aid a congressional re-evaluation of the government's taxing policy toward cooperatives.

pared by the Senate Finance Committee gave to the cooperatives until the 15th day of the third month after the close of their fiscal year to make their distribution or rebates of allocation of earnings. I submit that the time is too short within which farm cooperatives can have audits made of their books and notify their large number of shareholders and patrons. . . . I am proposing to strike the word 'third' and inset the word 'ninth', so that the cooperatives would have until the middle of the ninth month after their fiscal year began to complete their audits, make their distributions and allocations, and notify their members." 97 CONG. REC. 12202 (Sept. 24, 1951).

For the calendar year 1951 the returns on Forms 1096 and 1099 must include patronage dividends, rebates and refunds totaling \$100.00 or more during the calendar year. A separate Form 1099 must be prepared for each patron to whom an allocation of \$100.00 or more has been made during the calendar year.